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No. 201.

JUN 28 1944
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

THE UNITED GAS IMPROVEMENT COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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TABLE OF CONTENTS OF PETITION AND BRIEF.

PETITION.

PAGE

Statement of Matter Involved 2

Jurisdiction 4

Statutes Involved 4

Questions Presented 6

Reasons Relied on for the Allowance of the Writ 6

BRIEF.

Opinions Below 9

Statement of Facts 9

Statutes Involved 9

Specification of Errors 9

Argument 10

I. Introductory 10

II. Petitioner Did Not Exchange its Stock and Unsecured Indebtedness 11

III. The Decree of the Reorganization Court was Binding Upon the Courts Below 13

IV. Conclusion 15

TABLE OF CASES CITED.

PAGE

Case *v.* Los Angeles Lumber Co., 308 U. S. 106 ..... 7, 12, 14

Fairbanks *v.* U. S., 306 U. S. 436 ..... 7, 11

Helvering *v.* William Flaccus Oak Leather Co., 313 U. S. 247 ..... 7, 11

Local Loan Co. *v.* Hunt, 292 U. S. 234 13

TABLE OF STATUTES CITED.

Bankruptcy Act, Section 77B 6, 10, 12

Internal Revenue Code, Section 1141(a) 4

Internal Revenue Code, Section 112(a) 7

Internal Revenue Code, Section 112(b)(3) 7

Internal Revenue Code, Section 112(g) 7, 10

Judicial Code, Section 240(a) 4

Revenue Act of 1936, Section 23(f) and (k) 4

Revenue Act of 1936, Section 112(a) 5, 7

Revenue Act of 1936, Section 112(b)(3) 5, 7, 11

Revenue Act of 1936, Section 112(g) 5, 7, 10, 11

TABLE OF MISCELLANEOUS CITATIONS.

Regulations 84, Article 112(a)-1 12

Regulations 94, Article 112(a)-1 ..... 7, 11

Regulations 101, Article 112(a)-1 12

Regulations 103, Section 19.112(a)-1 12

Regulations 111, Section 19.112(a)-1 12

Restatement of the Law of Judgments, Section 73(1) 13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944. No. .

The United Gas Improvement Company,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner, The United Gas Improvement Company, a corporation, by its attorneys, John H. Minds and William R. Spofford, prays that a Writ of Certiorari issue to review the decision of the United States Circuit Court of Appeals for the Third Circuit (R. 156) entered March 30, 1944, affirming the order of The Tax Court of the United States, entered October 9, 1942 (R. 111) redetermining a deficiency in income tax for the year 1937.

STATEMENT OF MATTER INVOLVED.

The United Gas Improvement Company, petitioner herein, is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania. In its income tax return for the year 1937, petitioner deducted the amount of its investment in the capital stock and unsecured indebtedness of Nashville Gas and Heating Company which was reorganized under Section 77B of the Bankruptcy Act during 1937. The deficiency here in question arises from the disallowance by respondent of the deductions so claimed.

Nashville Gas and Heating Company, a public utility operating corporation, was organized under the laws of Tennessee (R. 15). On January 1, 1937, its outstanding capital stock consisted of 8,000 shares of preferred stock and 16,000 shares of common stock, each share having a par value of $100. Petitioner owned all the preferred shares and 15,834.4 shares of common stock. 165.6 shares of common were owned by others (R. 20).

On January 1, 1937, Nashville Gas and Heating Company had outstanding $2,729,000 face amount of First Mortgage 5% Twenty-five Year Gold Bonds, issued in 1912, at which time $6,000,000 were authorized and $2,965,000 were issued (R. 20). Petitioner had guaranteed payment of both principal and interest of the first $2,000,000 of these bonds (R. 16) and on January 1, 1937, owned $37,000 face amount of guaranteed and $40,000 face amount of unguaranteed bonds (R. 20). Prior to January 1, 1937, petitioner had made unsecured loans to Nashville Gas and Heating Company aggregating $522,225 on which no interest was paid subsequent to June 30, 1934 (R. 19).

On July 5, 1935, Nashville Gas and Heating Company filed a petition for reorganization under Section 77B of the Bankruptcy Act, in the United States District Court for the Middle District of Tennessee (R. 20). On June

11, 1937, after a hearing and due consideration, the Court confirmed a plan of reorganization. Under the plan, petitioner was to pay to the trustee of the old guaranteed bonds cash sufficient to pay off principal and interest of these bonds. For this payment petitioner was to receive all the common stock of the reorganized company. Old unguaranteed bonds were to be exchanged, bond for bond, for new First Mortgage Bonds. The plan also provided that the common and preferred stockholders of the old company would receive no distribution of cash or securities on account of stock owned by them. Finally the plan provided that the unsecured debt payable to petitioner would be cancelled and petitioner would not receive any cash or securities on account of such debt (R. 21, 69-74).

Pursuant to the plan, Nashville Gas and Heating Company amended its charter so that its authorized capital stock was $2,000,000 (the amount of old guaranteed bonds) consisting of 20,000 shares of $100 par each, and authorized and executed new First Mortgage Bonds (R. 23). Petitioner (through the mortgage trustee) paid off the old guaranteed bonds (R. 22), received the new stock (R. 23) and exchanged its $40,000 of old unguaranteed bonds for a like amount of new First Mortgage Bonds (R. 23). The debt owed to petitioner was cancelled and the old common and preferred stocks were likewise cancelled (R. 23, 85, 88, 89).

In its income tax return for 1937, petitioner deducted the cost of its investment in preferred and common stock of Nashville Gas and Heating Company as a loss, believing that these shares had become worthless in that year when they were cancelled and nothing was received in exchange for them. Petitioner also deducted the amount of the unsecured indebtedness because the debt was ascertained to have become worthless in 1937 and was charged off in that year.

The respondent disallowed these deductions and was sustained by The Tax Court, three Judges dissenting, and

by the Circuit Court. Both courts took the position that, despite the decree of the reorganization court under which petitioner received nothing for its common or preferred stock or its unsecured indebtedness, and despite the fact that the other common stockholders received nothing whatsoever, the petitioner "in effect" exchanged its stock and indebtedness for new stock of the reorganized company (R. 109, 154).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. §347) and Section 1141 (a) of the Internal Revenue Code. The order of the Circuit Court of Appeals for the Third Circuit was entered March 31, 1944 (R. 156).

STATUTES INVOLVED.

The relevant sections of the Revenue Act of 1936 are the following: Sections 23 (f) and (k), Revenue Act of 1936, c. 690, 49 Stat. 1659, 1660.

"Sec. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

"(f) LOSSES BY CORPORATIONS.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

"(k) BAD DEBTS.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when

satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction."

Section 112 (a), (b) (3) and (g) (1) of the Revenue Act of 1936, c. 690, 49 Stat. 1678, 1679, 1681.

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

"(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section."

"(b) EXCHANGES SOLELY IN KIND.—

"(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

"(g) DEFINITION OF REORGANIZATION.—As used in this section and section 113—

"(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected."

QUESTIONS PRESENTED.

1. Whether petitioner is entitled to deduct from gross income its investment in preferred and common stock and unsecured indebtedness which were cancelled in a reorganization of the issuing corporation under Section 77B of the Bankruptcy Act, pursuant to a plan of reorganization approved by the Court which expressly provided that nothing was to be received in exchange therefor.

2. Whether, notwithstanding a plan of reorganization approved by the Court which expressly provided that nothing was to be received for petitioner's common and preferred stock and unsecured indebtedness, petitioner's investment in such stock and indebtedness can be considered an additional consideration for the common stock of the reorganized corporation which was issued to petitioner upon payment of First Mortgage Bonds which petitioner had guaranteed many years previous.

3. Whether the Tax Court and the Circuit Court of Appeals have the power to disregard the final decree of the United States District Court for the Middle District of Tennessee, which approved a plan of reorganization under Section 77B of the Bankruptcy Act, and which conclusively established the property rights of stockholders and creditors of the company being reorganized.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Courts below holding that petitioner received something in exchange for its stock and indebtedness, despite the reorganization Court's determination to the contrary, is probably in conflict with the fundamental reasoning in the decisions of this Court

in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, *Fairbanks* v. *U. S.*, 306 U. S. 436, and *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U. S. 247.

2. The decision of the Courts below holding that a taxpayer who owns securities which share in a reorganization and also securities which do not share is precluded under Section 112 of the Revenue Act of 1936 (which is substantially the same as Section 112 of the Internal Revenue Code) from deducting a loss with respect to the securities which do not share decides an important question of Federal law which has not been, but should be, settled by this Court.

3. The decision of the Courts below holding that petitioner received something in exchange for its stock and indebtedness, despite the reorganization Court's determination to the contrary, is in conflict with the established rules for the administration of Section 112 of the Revenue Act of 1936 and the corresponding provisions of earlier and subsequent revenue laws as set forth in respondent's Regulations 94, Article 112 (a)-1, and the corresponding articles of earlier and later regulations, which regulations had acquired the force of law through subsequent enactment of similar laws by Congress without substantial change.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Third Circuit, sitting at Philadelphia, Pennsylvania, commanding said Court to certify and send to this Court on a day to be designated, a full and complete transcript of the records of all proceedings had in this cause, to the end that this cause may be reviewed and determined by this Court; that the order referred to at page 1 hereof be set aside and reversed, and

that petitioner be granted such other and further relief as may be just and proper.

THE UNITED GAS IMPROVEMENT COMPANY,

By

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Dated June 28, 1944.

BRIEF IN SUPPORT OF PETITIONER.

OPINIONS BELOW.

The opinion of The Tax Court (R. 95-110) was promulgated September 22, 1942, and is reported at 47 B. T. A. 715. The opinion of the Circuit Court of Appeals (R. 147 to 155) was rendered March 31, 1944, and is reported at 142 F. (2d) 216.

STATEMENT OF FACTS.

The pertinent facts are set forth in the foregoing petition at pages 2 to 4 hereof.

STATUTES INVOLVED.

The relevant provisions of the Revenue Act of 1936 are set forth in the petition at pages 4 and 5 thereof.

SPECIFICATION OF ERRORS.

The errors which petitioner will urge, if the writ of certiorari be granted, are that the Circuit Court erred:

1. In disregarding the express provisions of the plan of reorganization of Nashville Gas and Heating Company as confirmed by the reorganization court and in holding that petitioner exchanged its old stock and unsecured indebtedness for new stock of the reorganized company.

2. In failing to hold that petitioner received nothing for its common and preferred stock of Nashville Gas and Heating Company upon reorganization, that such stock became worthless in 1937 and that petitioner was entitled to deduct its investment in such stock as a loss.

3. In failing to hold that petitioner received nothing for its unsecured indebtedness of Nashville Gas and Heating Company upon reorganization and that petitioner was entitled to deduct the amount thereof in its income tax return for 1937, having ascertained it to be worthless and having charged it off in that year.

ARGUMENT.

I. Introductory.

The question presented by this case is of paramount importance to many holders of securities of companies which have reorganized under Section 77B of the Bankruptcy Act or under the provisions of other Federal or local laws giving rise to "reorganizations" as defined by Section 112(g) of the Revenue Act of 1936 and the corresponding provisions of prior and subsequent Revenue Acts and of the Internal Revenue Code. It frequently happens that in such proceedings, as in the instant case, junior securities are denied participation in the reorganized company. Not infrequently the holders of such junior securities are also the holders of senior securities which are permitted to share in the reorganization. Those who own only such junior securities cannot be said to have exchanged anything and they are therefore entitled to deduct their investment in such securities in the year of worthlessness. At the opposite end are those who own only senior securities which are entitled to participate in the plan. As to them, assuming a "reorganization" within the definition of Section 112(g) of the Internal Revenue Code and the corresponding provisions of prior Revenue Acts, there is unquestionably an exchange of old securities for new and any gain or loss is postponed until disposition is made of the new securities. Between these two extremes are those who own both junior securities,

not entitled to participation, and senior securities, entitled to participation. The Court below has said that such holders must treat their holdings as one package in exchange for which they receive new securities, even though such new securities are available to the holder only because of his holding of senior securities.

II. Petitioner Did Not Exchange Its Stock and Unsecured Indebtedness.

Although petitioner has not contested the finding that the reorganization of Nashville Gas and Heating Company was a "recapitalization" and hence a "reorganization" under Section 112(g) of the Revenue Act of 1936, both courts below devoted considerable space in their opinions to this point as though it necessarily followed that no loss could be allowed where there was a reorganization. In order for loss to be denied under Section 112(b)(3) of the Revenue Act of 1936, it is essential that there be an exchange.

This Court in *Fairbanks* v. *United States*, 306 U. S. 436, involving the Revenue Acts of 1926 and 1928, stated:

> "Payment and discharge of a bond is neither a sale nor exchange within the commonly accepted meaning of the words",

thereby setting up a requirement that "exchange" as used in the revenue laws must be given its everyday meaning.

Again in *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U. S. 247, holding proceeds of fire insurance not to have been received in an exchange, this Court said:

> "'exchange' * * * implies reciprocal transfers of capital assets, * * *."

Article 112(a)-1 of respondent's Regulations 94 (under the Revenue Act of 1936) provides:

> "* * * To constitute an exchange within the meaning of section 112(b)(1) to (5), inclusive, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only. * * *"*

Both the Circuit Court and The Tax Court have held that petitioner "exchanged" its stock and unsecured indebtedness in the reorganization of Nashville Gas and Heating Company, although both the plan of reorganization and the decree of the reorganization court confirming such plan definitely provided that nothing should be received by petitioner for its stock or unsecured indebtedness. In disregarding the decree of the reorganization court and holding that there was such exchange in the instant case the decisions of the lower courts are in conflict with the decision of this Court in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, wherein it was held that as a matter of law a plan of reorganization under Section 77B of the Bankruptcy Act could not be confirmed if it provided for distribution of securities of the reorganized company to holders of securities of the old company having no equity. Under this decision the reorganization court would not have provided for distribution of new securities to petitioner with respect to its stock and unsecured indebtedness. Nevertheless, both courts below held that this was what was done "in effect".

The error of the decisions below is most clearly apparent in the case of the common stock owned by petitioner. Although a large majority of this stock was owned by petitioner there was a minority owned by outsiders. It cannot be said that a plan of reorganization would have been "fair and equitable" as required by Section 77B if it had provided that petitioner would re-

* This provision is the same as in Regulations 111 (1943) Sec. 19.112 (a)-1; Regulations 103 (1940) Sec. 19.112(a)-1; Regulations 101 (1938) Art. 112(a)-1; Regulations 84 (1934) Art. 112(a)-1.

ceive something for its majority interest but that the minority would receive nothing.*

III. The Decree of the Reorganization Court Was Binding Upon the Courts Below.

The reorganization proceeding of Nashville Gas and Heating Company was an *in rem* proceeding. *Local Loan Co.* v. *Hunt*, 292 U. S. 234. The decree of the reorganization court was a decree *in rem* and provided that the rights of all stockholders were terminated, that the debt was cancelled and that nothing should be received in exchange for the stock and debt, title to which was divested (R. 85, 86).

A judgment *in rem* of a competent court is conclusive upon all persons as to interests in the thing. Restatement of the Law of Judgments, Section 73(1). The rule is elaborated in Comment a to Section 73, as follows:

> "*Effect of judgment on interests in a thing.* Where in a proceeding *in rem* a competent court has after proper notice determined interests in property over which the court has jurisdiction, the determination of those interests is binding on all persons in the world. (See §2.) The judgment is not subject to collateral attack by anyone, unless the judgment was void because the court did not have jurisdiction over the thing or was not competent to render the judgment or there was a failure to give proper notice and

*The Circuit Court determined that after the reorganization the new common stock had a book value which included approximately $800,000 ascribable to the old preferred and common (R. 151). Assuming *arguendo* that the Court's theory is correct it should, at least, have held the common stock to be worthless because the preferred stock which had preference in distribution had a par value of $800,000 and dividends accumulated thereon amounted to $408,000 (R. 39). However, this mathematical determination based on book values must give way to the reorganization court's adjudication that the plan, which provided nothing for old preferred and common stockholders, did not discriminate against any class (R. 79).

opportunity to be heard. (See §32.) As far as interests in the thing are concerned, the judgment is binding not only on persons who were subject to the jurisdiction of the court which rendered the judgment, but also on persons not personally subject to the jurisdiction of the court."

Applied to the instant case the foregoing principles are not mere abstract legal concepts but constitute a sound basis for decision. The District Court of the United States for the Middle District of Tennessee, not The Tax Court nor the Circuit Court of Appeals for the Third Circuit, had jurisdiction of the reorganization proceedings. In *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, this Court stated at pages 114 and 115:

"* * * Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. This is in line with the decision of this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, which reversed an order approving a plan of reorganization under §77B, in spite of the fact that the requisite percentage of the various classes of security holders had approved it, on the ground that preferred stock of the debtor corporation was inequitably treated under the plan. The contrary conclusion in such cases would make the judicial determination on the issue of fairness a mere formality and would effectively destroy the function and the duty imposed by the Congress on the district courts under §77B. That function and duty are no less here than they are in equity receivership reorganizations, where this Court said, 'Every important determination by the court in receivership proceedings calls for an informed, independent judgment.' *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436."

The decree of the reorganization court cannot be considered, as it was by the courts below, as a mere formality confirming the whim of the security holders. The court's determination that the plan was "fair and equitable" must be recognized to have been based on an informed, independent judgment after a study of all the facts of the reorganization proceeding. As such the decree is not open to collateral attack.

IV. Conclusion.

This Court should grant the Writ of Certiorari to review the decision of the Court below on all issues herein.

Respectfully submitted,

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No. 301

In the Supreme Court of the United States

October Term, 1944

THE [illegible]

[illegible]

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR [illegible]

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	8
Conclusion	10
Appendix	11

CITATIONS

Cases:	
Case v. *Los Angeles Lumber Co.*, 308 U. S. 106	9
Dobson v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231	9
Fairbanks v. *United States*, 306 U. S. 436	8
Helvering v. *Cement Investors*, 316 U. S. 527	10
Helvering v. *Flaccus Leather Co.*, 313 U. S. 247	8
Helvering v. *Limestone Co.*, 315 U. S. 179	10
Helvering v. *Southwest Corp.*, 315 U. S. 194	8
Local Loan Co. v. *Hunt*, 292 U. S. 234	9
Wilmington Co. v. *Helvering*, 316 U. S. 164	9
Statute:	
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 112	8, 11
Miscellaneous:	
Treasury Regulations 94:	
Art 112 (a)–1	8, 12
Art. 112 (g)–1	12
Art. 112 (g)–2	13

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 201

THE UNITED GAS IMPROVEMENT COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the United States Board of Tax Appeals (R. 95–110) is reported in 47 B. T. A. 715. The opinion of the Circuit Court of Appeals (R. 147–155) is reported in 142 F. 2d 216.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 31, 1944 (R. 155–156). The petition for a writ of certiorari was filed June 28, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer held all of the preferred and 98.97% of the common stock of a corporation which was reorganized under Section 77B of the Bankruptcy Act. The taxpayer was also a bondholder and a general creditor and had guaranteed certain bonds. As a result of the reorganization proceedings, the taxpayer received the entire new issue of the common stock, the indebtedness to the taxpayer was eliminated, the guaranteed bonds were paid, and the unguaranteed bonds were exchanged for new bonds. Does Section 112 (b) (3) of the Revenue Act of 1936 prevent the recognition of the taxpayer's alleged loss?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra,* pp. 11–14.

STATEMENT

The case was heard before the Board of Tax Appeals on a stipulation of facts. The petitioner, The United Gas Improvement Company (hereinafter referred to as the taxpayer), is a corporation organized under the laws of the Commonwealth of Pennsylvania, with its principal office in Philadelphia, Pennsylvania (Stip. par. 1, R. 15). Just prior to the July 5, 1935, reorganization proceedings involved in this case, and hereinafter described, under Section 77B of the Bankruptcy Act, the taxpayer was the substantial

owner through the ownership of nearly all the stock, common and preferred, of the Nashville Gas and Heating Company, a corporation organized under the laws of the State of Tennessee. At the time the above-mentioned bankruptcy proceedings were commenced, the taxpayer was the holder of 15,834.4 shares of a total issue of 16,000 shares, or 98.97% of the common stock of the Nashville Gas and Heating Company, which had a par value of $100 per share. (Stip. pars. 2, 4, R. 15; Stip. par. 29, R. 20.) The taxpayer also was the holder of the entire issue of 8,000 shares of preferred stock of that company with a par value of $100 per share (Stip. par. 4, R. 15; Stip. par. 29, R. 20). The Nashville Gas and Heating Company had outstanding, besides the above-mentioned stock, $1,954,000 par value first mortgage bonds, which were guaranteed as to principal and interest by the taxpayer. The taxpayer held $37,000 par value of these bonds. (Stip. par. 5, R. 15; Stip. par. 9, R. 16; Stip. par. 29, R. 20.) The Nashville Gas and Heating Company also had outstanding $775,000 par value of first mortgage bonds not guaranted by the taxpayer. Of these latter bonds, the taxpayer itself held bonds of $40,000 par value. (Stip. par. 29, R. 20.) In addition, the taxpayer was heavily interested in the Nashville Gas and Heating Company as a general creditor to the extent of $522,225 for advances on which interest had been paid

to June 30, 1934 (Stip. par. 22, R. 19). As previously mentioned, the taxpayer was also contingently interested in the Nashville Gas and Heating Company by virtue of the taxpayer's guarantee upon $1,954,000 of the bonds of the latter company.

On December 31, 1936, before the execution of the reorganization proceedings under Section 77B of the Bankruptcy Act, hereinafter described, the balance sheet of the Nashville Gas and Heating Company (Stip. Schedule 1, R. 33–34) showed assets of $6,294,854.15, and liabilities, apart from the capital stock account, of $4,035,297.51, leaving a book value of the common and preferred capital stock of $2,259,556.64.

On July 5, 1935, the Nashville Gas and Heating Company filed in the United States District Court for the Middle District of Tennessee a petition for the reorganization of the corporation under Section 77B of the Bankruptcy Act (Bankruptcy Act, 1898, c. 541, 30 Stat. 544, as amended by the Act of June 7, 1934, c. 424, 48 Stat. 911, Section 1), setting forth that the company was a debtor unable to meet its debts as they matured and that it was desirous of effecting a plan of reorganization (Stip. par. 30, R. 20; Schedule 6, par. 8, R. 43). On September 20, 1935, a plan of reorganization was filed with the court, but never adopted, due to objections of certain owners of the aforesaid unguaranteed bonds (Stip. par. 33, 34, R. 21;

Schedule 7, R. 55–64). On March 16, 1936, a new "Plan of Reorganization" was filed with the court (Stip. par. 35, R. 21; Schedule 9, R. 67–76) and approved by the court on June 11, 1937 (Stip. par. 36, R. 22; Schedule 10, R. 77–86), with a modification, immaterial in this case, on June 21, 1937 (Stip. par. 37, R. 22).

The plan as adopted and approved (Schedule 9, R. 68–76; Schedule 10, R. 77–86) was in substance as follows:

1. The holders of the common stock (98.97% held by the taxpayer) and of the preferred stock (100% held by the taxpayer) would receive nothing for their shares (R. 71), and the same were to be cancelled (Schedule 10, par. 11 (c), R. 84).

2. The holders of the first mortgage bonds guaranteed by the taxpayer were to receive the face value thereof with interest to May 1, 1937, the amount necessary to pay the same to be paid by the taxpayer under its guarantee (Schedule 9, par. IV (a), (c), R. 69, 70).

3. The holders of the unguaranteed first mortgage bonds were to receive dollar for dollar new first mortgage bonds due in 1951 (Schedule 9, par. IV (b), R. 70).

4. The loan of $522,225 by the taxpayer to the Nashville Gas and Heating Company was to be cancelled (Schedule 9, par. IV (c), R. 71).

5. All other claims of creditors were to be paid in full in cash (Schedule 9, par. II, R. 69).

6. On the payment by the taxpayer under its guarantee to the trustee of the bondholders of the sum necessary to satisfy the first mortgage bonds guaranteed by it, the taxpayer was to receive the entire issue of the new common stock of the Nashville Gas and Heating Company, *viz.*, 20,000 shares of common stock of a par value of $100 per share (Schedule 9, par. IV (c), R. 70).

Upon the approval of the plan by the court on June 11, 1937, the Nashville Gas and Heating Company wrote down its plant, property and equipment accounts by the sum of $1,665,785.33, with the approval of the Railroad and Public Utilities Commission of the State of Tennessee (Supp. Stip. par. 2, R. 94).

The plan as approved was carried out. On April 23, 1937, the taxpayer paid to the trustee for the bondholders $1,964,925, the sum necessary to pay the bonds guaranteed by it, except those held by the taxpayer, with the interest thereon, and such sum was duly disbursed to the bondholders (Stip. par. 38, R. 22).

On or about August 25, 1937, the Nashville Gas and Heating Company issued to the taxpayer 20,000 shares of its new common stock (Stip. par. 42, R. 23). On or about the same date, the company also issued its new first mortgage bonds for the face amount of $775,000 to be delivered to the former owners of the old unguaranteed first mort-

gage bonds of the same amount (Stip. par. 41, R. 23).

On April 11, 1938, the United States District Court for the Middle District of Tennessee entered its final decree determining that the plan of reorganization had in all respects been fully executed and carried out and the proceedings were to be declared terminated (Stip. Schedule 12, R. 90–93).

On December 31, 1937, when the reorganization plan was consummated, except for the final approval of the court, the balance sheet of the Nashville Gas and Heating Company (Stip. Schedule 1, R. 35–36) showed assets of $4,578,907.89, and liabilities, apart from the capital stock account, of $1,268,629.64, leaving a book value for the common stock of $3,310,278.25. This was after the plant, property and equipment accounts had been written down, June 11, 1937, by the amount of $1,665,785.33.

In its income and excess profits tax return for the year 1937, the taxpayer claimed deductions on account of its alleged loss in its investment in the old common and preferred shares of the Nashville Gas and Heating Company and on account of the cancelled debt of $522,225 (R. 103). The Commissioner disallowed the deductions on the ground that there was a reorganization of the company within the meaning of Section 112 (g)

of the Revenue Act of 1936, and he accordingly assessed a deficiency (R. 104). The Board of Tax Appeals sustained the action of the Commissioner (R. 95–111), and the court below affirmed (R. 155).

ARGUMENT

The court below held, correctly, we submit, that there was a recapitalization (*Helvering* v. *Southwest Corp.*, 315 U. S. 194, 202) and hence a reorganization under Section 112 (g) of the Revenue Act of 1936 (Appendix, *infra*, pp. 11–12); also an exchange of securities for securities under subdivision (b) (3) of Section 112 (Appendix, *infra*, p. 11) so that no loss could be recognized on the transaction. The taxpayer admits there was a reorganization (Pet. 11), but contends that there was no exchange, citing in support of that contention *Fairbanks* v. *United States*, 306 U. S. 436; *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247; and Article 112 (a)–1 of Treasury Regulations 94 (Appendix, *infra*, p. 12). However, the *Fairbanks* and *Flaccus* cases are not in point; they relate to different taxable situations and statutory provisions, and the holdings there do not conflict with the decision here. Nor is the provision of the regulations referred to at variance with the instant decision. That provision is to the effect that to constitute an exchange within the meaning of Section 112 (b) (1)–(5), inclusive, the transaction must be a reciprocal transfer of

property; and here there was certainly such a transfer. The Board of Tax Appeals so found (R. 109), and that finding being based upon substantial evidence was properly upheld by the court below (R. 154). *Wilmington Co.* v. *Helvering*, 316 U. S. 164; *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.

The taxpayer urges (Pet. 7, 12) that there is a conflict with *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, but clearly no such conflict exists. That case involved the question whether a certain reorganization plan was "fair and equitable" within the meaning of Section 77B of the Bankruptcy Act, and the opinion does not suggest that a transaction such as here involved could not be considered as an exchange within the purview of Section 112 (b) (3).

The taxpayer also contends (Pet. 13–15) that the decree of the reorganization court was binding upon everybody and that the Board of Tax Appeals and the court below, in passing upon the tax consequences of the plan, had no authority to disregard the provisions therein to the effect that nothing should be received by the taxpayer in exchange for its stock and claim. *Local Loan Co.* v. *Hunt*, 292 U. S. 234, relied upon by the taxpayer (Pet. 13), does not support this contention. It holds that a court of bankruptcy has jurisdiction by ancillary proceedings to enforce an order of discharge by enjoining the prosecution of suits

brought against the debtor; and is not out of harmony with the view taken by the Board of Tax Appeals and Circuit Court of Appeals (R. 109, 154) that, irrespective of the wording of the plan, the Commissioner properly looked through form to substance and applied the familiar rule (*Helvering* v. *Limestone Co.*, 315 U. S. 179, 184–185) that a single plan or scheme may not be broken up into separate steps for tax purposes.

Here the taxpayer's money is still tied up in the same kind of property as that in which it was originally invested (R. 152–153), and it has not been shown that taxpayer closed out a losing venture (*Helvering* v. *Cement Investors*, 316 U. S. 527, 533). Hence, there is no adequate basis for the claimed deduction.

CONCLUSION

The decision is correct and there is no conflict. Accordingly, the petition should be denied.

Respectfully submitted.

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the

voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

Treasury Regulations 94, relating to the Revenue Act of 1936:

ART. 112 (a)–1. *Sales or exchanges.*—

* * *

* * * * *

To constitute an exchange within the meaning of section 112 (b) (1) to (5), inclusive, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

* * * * *

ART. 112 (g)–1. *Purpose and scope of exception of reorganization exchanges.*—*Purpose:* Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Act is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Act, as are required by

business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Act are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. * * *

Scope.—The nonrecognition of gain or loss is prescribed for two specifically described types of exchanges, viz: The exchange that is provided for in section 112 (b) (3) in which stock or securities in a corporation a party to the reorganization are, in pursuance of a plan of reorganization, exchanged for the stock or securities in a corporation a party to the same reorganization; and the exchange that is provided for in section 112 (b) (4) in which a corporation a party to the reorganization exchanges property, in pursuance of a plan of reorganization, for stock or securities in another corporation a party to the same reorganization. Section 112 (g) limits the definition of the term "reorganization" to five kinds of transactions and excludes all others. * * *

* * * * *

ART. 112 (g)–2. *Definition of terms.*—The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 112 (g) (1). * * *

* * * * *

A "recapitalization," and therefore a reorganization, takes place if, for example,

(1) A corporation with $200,000 par value of bonds outstanding, instead of pay-

ing them off in cash, discharges them by issuing preferred shares to the bondholders, par for par;

(2) There is surrendered to a corporation for cancellation 25 percent of its preferred stock in exchange for no par value common stock;

(3) A corporation issues preferred stock, previously authorized but unissued, for outstanding common stock; or

(4) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock having no such rights.

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